DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 02-0479
GROSS INCOME TAX
For the 1998 Tax Year

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. **Money Earned from Providing Construction Management Services** – Gross Income Tax.

Authority: IC 6-2.1-2-2(a)(2); IC 6-8.1-5-1; 45 IAC 1-1-19; 45 IAC 1-1-49; 45 IAC 1-1-121(a).

Taxpayer claims that the Department of Revenue (Department) erred when it determined that money earned from providing construction management services was subject to the state's gross income tax. Taxpayer maintains that this money is not Indiana source income.

II. **Ten-Percent Negligence Penalty**.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer argues that it is entitled to abatement of the ten-percent negligence penalty.

III. **Abatement of the Ten-Percent Underpayment Penalty**.

Authority: IC 6-3-4-4.1(e); IC 6-8.1-10-2.1(b).

Taxpayer claims that the ten-percent quarterly underpayment penalty should be abated because taxpayer had adequate grounds for calculating its 1998 state income tax liability as it did.

STATEMENT OF FACTS

Taxpayer is an out-of-state company which was in the business of providing construction and design services to steel mill companies building new facilities or revamping existing facilities.

In 1996, taxpayer's sister company entered into a multi-year contract to design and build a steel mill in Indiana. The steel company hired the sister company to provide engineering, procurement, and construction management services. The sister company then subcontracted with taxpayer to provide all the construction management services that were to be performed in relation to the new steel mill. During a prior audit, the Department determined that taxpayer did

not have Indiana source income for gross income tax purposes because actual construction at the Indiana site was not set to commence until 1997 and because all previous services were rendered at taxpayer's out-of-state location.

Taxpayer filed a 1998 consolidated corporate income tax return, but claimed that it had no Indiana gross income tax liability. During 2002, the Department conducted an audit of the 1998 tax year and found that taxpayer owed gross income taxes attributable to the Indiana construction project. Accordingly, the Department sent notices of proposed assessment. Taxpayer disagreed with the assessment and submitted a protest to that effect. Correspondence was exchanged between taxpayer and the Department with taxpayer contending that it had gone into receivership and declining the opportunity to further explain the basis for its initial tax protest. This Letter of Findings was written addressing the substance of taxpayer's tax protest. Questions concerning taxpayer's receivership are not at issue.

DISCUSSION

I. Money Earned from Providing Construction Management Services – Gross Income Tax.

Taxpayer earned money because it provided construction management services related to the construction of an Indiana steel mill. The Department concluded that a portion of this income stemming from the performance of services at the Indiana site (47 percent) was subject to gross income tax.

Taxpayer disagrees stating the income is not Indiana source income on the ground that less than five-percent of its construction management activities occurred in Indiana.

The issue is whether taxpayer received gross income when it performed management services in support of the Indiana steel mill project.

IC 6-2.1-2-2(a)(2) imposes the gross income tax "upon the receipt of . . . the taxable gross income derived from activities or businesses or any other sources with Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." Id. 45 IAC 1-1-19 states that, "For the purpose of this Act [IC 6-2.1] and these regulations a 'trade,' 'business' or the carrying on of 'commerce' includes any activity in which *a service is provided* or property is rented, sold, transferred, exchanged, manufactured, produced or otherwise generated gross income to the owner, transferor, manufacturer, or producer." (*Emphasis added*).

Taxpayer concedes that the money it earned constituted gross income. Under 45 IAC 1-1-19, the gross income a nonresident taxpayer receives from providing services within Indiana is subject to gross income tax is taxable. However, taxpayer argues the service income it received during 1998 is not taxable because its activities in Indiana were de minimis. Specifically, taxpayer states that, "Minimal service activities within Indiana have been held insufficient to impose gross income tax on income related to the performance of services."

45 IAC 1-1-49 provides that "a taxpayer may establish a 'business situs' in ways including, but not limited to . . . . [p]erformance of services." However, taxpayer claims that because most of the service work was performed at its out-of-state location and because its presence within Indiana was so limited, that it never established a "business situs" within the state. In support, taxpayer points to 45 IAC 1-1-121(a) which reads as follows:

> Income from a contract for the performance of services within the state is subject to gross income tax. However, if the contract calls for the performance of services both within and without the State by a nonresident with no in-state business situs and the non-resident's performance within the State is minimal or incidental in comparison to his performance out-of-state, no service income will be taxed. In determining what will be considered "minimal" or "incidental" the Department has formulated these guidelines. If five percent (5%) or less of the total hours or total fee under the contract in any tax year is attributable to services performed in Indiana, the entire proceeds of the contract received in that year are exempt from gross income tax.

Taxpayer states that it "did not perform more than five percent (5%) of its services in Indiana, therefore, none of the receipts received [] under the Agreement is subject to gross income tax." The parties' agreement does not bear out taxpayer's contention. The Agreement contains a "summary of our estimated manpower requirements for the project broken down between Home Office and Field Services." The agreement states that the steel mill project would consume 722,900 total man-hours, that 387,700 of those hours would be spent at the out-of-state home office, and that 335,200 hours would be spent at the Indiana construction site. Based on these figures, approximately 47 percent of the time spent on the project would be spent at the Indiana construction site. The 47 percent figure is the same number used by the audit in calculating taxpayer's gross income tax liability. Taxpayer's contention – that less than 5 percent of its services were provided in Indiana and that more than 95 percent were provided at its home office – is not supported. To the contrary, if one were to consider only that portion of the project related to "construction management" – which is taxpayer's contribution to the steel mill project – the 290,000 hours attributable to "construction management" were spent exclusively at the Indiana location.

Pursuant to IC 6-8.1-5-1, taxpayer has failed to meet its burden of demonstrating that the audit's calculation of taxpayer's gross income liability and the consequent assessment are wrong.

FINDING

Taxpayer's protest is respectfully denied.

II. Ten-Percent Negligence Penalty.

Taxpayer argues that the Department should waive the ten-percent negligence penalty because it had reasonable cause for deciding that it was not subject to gross income tax during 1998.

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the

failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

The Department is unable to agree that failure to report any of the income received from performing services constitutes the "reasonable care, caution, or diligence as would be expected from an ordinary reasonable taxpayer." 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the Ten-Percent Underpayment Penalty.

Taxpayer asks that the Department abate the ten-percent penalty which was assessed because taxpayer underpaid its quarterly estimated taxes. Taxpayer makes this argument because it believes it had adequate grounds for determining its 1998 Indiana tax liability as it did.

IC 6-3-4-4.1(e) states as follows:

> The penalty prescribed by IC 6-8.1-10-2.1(b) shall be assessed by the department on corporations failing to make payments as required in subsection (d) or (g). However, no penalty shall be assessed as to any estimated payments of adjusted gross tax plus supplemental net income tax plus gross income tax which equal or exceed:
>
> > (1) twenty percent (20%) of the final tax liability for such taxable year; or
> >
> > (2) twenty-five percent (25%) of the final tax liability for the taxpayer's previous taxable year.
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> In addition, the penalty as to any underpayment of tax on an estimated return shall only be assessed on the difference between the actual amount paid by the corporation on such estimated return and twenty-five percent (25%) of the sum of the corporation's final adjusted gross income tax plus supplemental tax income tax liability for such taxable year.

IC 6-8.1-10-2.1(b) sets the amount of penalty as ten percent.

Taxpayer was assessed a penalty because it underpaid its quarterly estimated tax. Taxpayer does not challenge the manner in which the amount of penalty was calculated but repeats its substantive argument that the construction management income was not subject to the state's gross income tax.

In effect, taxpayer asks the Department to abate the underpayment penalty because taxpayer presented a colorable argument justifying its failure to report the income. Taxpayer asks the Department to exercise a discretionary authority it does not have. Without finding that taxpayer was correct when it estimated its 1998 income tax liability, the Department has no authority to abate the underpayment penalty.

FINDING

Taxpayer's protest is respectfully denied.

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